

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 90-588-G - ORDER NO. 98-503

JULY 6, 1998

IN RE: South Carolina Pipeline Corporation –                   )  
Maximum Rates for Industrial Customers                   ) ORDER DENYING  
  ) PETITION FOR  
  ) REHEARING AND  
  ) RECONSIDERTION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Petition of the South Carolina Energy Users Committee (SCEUC) for rehearing and reconsideration of our Order on Remand in this Docket, Order No. 98-415. By order of the Circuit Court, this Commission was to set a fair overall rate of return for South Carolina Pipeline Corporation (SCPC or Pipeline). Order No. 98-415 resulted, and SCEUC has requested rehearing and reconsideration of that Order. Because of the reasoning stated below, we deny the Petition.

For the most part, SCEUC's petition expresses disagreement with the way in which the Commission resolved conflicting evidence on various issues raised in this proceeding. The record shows, however, that this Commission's decision is fully supported by substantial evidence and reflects an appropriate exercise of discretion. SCEUC's petition fails to present any valid grounds for modification of our decision.

First, SCEUC alleges that our decision to strike certain testimony of SCEUC's witness Phillips regarding the inclusion of the plant acquisition adjustment in the utility's rate base on the grounds that such testimony was irrelevant was error. SCEUC states that

because the Commission's "duty" in this Docket was not only to establish a fair overall rate of return for the total operations of SCPC, but also to set fair and reasonable prices based on that rate of return, the testimony was both relevant and critical to our completion of this "duty." First, we disagree that our charge in this remand included setting prices based on the set return. We believe that our only "duty" under the Circuit Court's remand Order was to determine a fair overall rate of return for Pipeline. Further, we do not believe that the Supreme Court's decision in Nucor Steel v. South Carolina Public Service Commission, 312 S.C. 79, 439 S.E. 2d 270 (1994) directed us to determine reasonable prices at this time either. The plant acquisition adjustment is irrelevant in determining a fair overall rate of return. We hold that the acquisition adjustment is an accounting issue to be addressed, if at all, only in a rate case in which SCPC's rate base is determined.

The Circuit Court interpreted the Nucor Steel decision to require that "a fair overall company return must be established, and prices must be set by a method which will ensure that only a fair overall return is earned." Consistent with this direction, the Commission established a fair overall rate of return for Pipeline in Order No. 98-415, and properly decided that it would use the return on equity range to monitor Pipeline's future earnings. SCEUC's proffered testimony concerning one aspect of a rate base determination introduced an inappropriate issue into this remand proceeding and, therefore, we hold that the proffered testimony was properly stricken.

Second, SCEUC states its belief that the Commission's finding that SCPC's actual capital structure is reasonable was error. We disagree. Although SCEUC's witness Gorman did testify that the company's equity ratio is higher than the average equity ratio of other gas companies, he did not conclude that SCPC's capital structure was unreasonable. In fact Gorman used the capital structure recommended by SCPC witness Malkiel in calculating an overall rate of return estimate.

Moreover, as pointed out by Dr. Malkiel, Mr. Gorman's reliance upon SCPC's affiliation with a large parent company is an inappropriate consideration for assessing SCPC's cost of capital. According to the "stand-alone principle" of corporate finance, a company should use a cost of capital for the project being financed to determine the cut-off rate for investment. Thus, the appropriate cost of capital for investments in SCPC is SCPC's cost of capital, which can only be estimated by finding the required rate of return on investments having the same risk as SCPC.

SCEUC's contention regarding SCPC's revenue volatility will be discussed below.

Third, SCEUC takes issue with the Commission's statement that the evidence of the variability and volatility of SCPC's revenue and returns confirms the competitiveness of its industrial fuels market. SCEUC contends that "practically all" of this variability and volatility "was directly attributable to fluctuations in the utilities' (sic) cost of gas" and that, "because increases in that expense are passed along to the company's customers through fuel adjustment clauses, the revenue volatility should not lead to volatility in the company's net income." The evidence showed, however, that SCPC does experience

volatility in its net income, revenues, and returns on equity. Hearing Exhibit 7, Exhibit JES-3. Thus, SCEUC's assertions are not supported by the record. Next, SCEUC contends that the higher margin that SCPC earned from industrial customers, as opposed to resale customers somehow indicates a lack of competition. Dr. Malkiel testified that higher profit margins are consistent with more volatile businesses. Thus SCEUC's contention is again unsupported by the record. Lastly, SCEUC contends that "the meaningful inquiry is not whether SCPC competes with alternate fuels in its industrial market, but whether SCPC has competition for the transportation of natural gas in its service territory." This Commission has previously rejected this same argument in Order No. 90-729, Docket No. 90-204-G, finding that the relevant industrial market includes all alternative fuel sources and concluding that SCPC's industrial fuel market is, in fact, competitive. These findings and conclusions were effectively affirmed by the South Carolina Supreme Court in Nucor Steel, *supra*, 439 S.E. 2d at 271 n.2. Furthermore, this Commission earlier refused to adopt SCEUC's argument and its witnesses' testimony in this same case, reaffirming in Order No. 95-1717 its prior findings that competition exists. As we noted in Order No. 98-415, the Circuit Court Order remanding this matter did not disturb the finding of competition and, in fact, the issue of competition has already been decided for purposes of this proceeding.

SCEUC next contends that this Commission erroneously referred to the fact that as few as ten industrial customers contribute 60% of SCPC's industrial revenues as evidence to confirm the competitiveness of the industrial fuels market. Although he did not know the details, SCPC witness Hulse testified, without objection, that 60% of

SCPC's industrial revenues are derived from only ten customers. This Commission's conclusion therefore does have a foundation in the record. In any event, as noted above, the issue of competition is not before the Commission at this juncture, since it has already been decided.

Further, SCEUC argues that this Commission erroneously rejected the CAPM and risk premium techniques by failing to explain why "adjustments in those models made by certain of the witnesses using them were inadequate to address the deficiencies cited by Dr. Malkiel." We held in Order No. 98-415 that the 60-month historical betas used in the CAPM did not adequately reflect the future risk faced by SCPC in the rapidly changing utility environment. Further, we held in that Order that, with regard to the risk premium analysis, there were questions about what bond rate to use as a base and development of the equity risk premiums was shown to be sufficiently uncertain, so that we found it inappropriate to rely on that technique in this case. We believe that these problems were sufficient grounds to reject the two techniques in this case only. No one addressed ways to correct these and other problems. Accordingly, this argument is without merit.

SCEUC next contends that this Commission erroneously concluded that the betas used in the CAPM do not adequately reflect the risks Pipeline will face in the rapidly changing utility environment. It states, incorrectly, "As the Commission is well aware, SCPC faces absolutely no adverse change in its environment." Pipeline witness Hulse described the increased competition that is associated with continued utility deregulation, the possible repeal of the Public Utility Holding Company Act, and more full-service energy "superstores." This supports this Commission's conclusion on this matter.

In addition, SCEUC argues that this Commission erroneously failed “to consider the results of Mr. Gorman’s Nonconstant Growth DCF Model” and failed “to adequately consider and address” his testimony as to why he used this version. As Dr. Malkiel testified, Mr. Gorman’s use of the nonconstant growth analysis was based upon the incorrect belief that the constant growth model assumes perpetual growth at the forecasted rates when, in fact, it assumes only finite growth for five years and no change in general market valuation levels. For this reason, the Commission properly rejected the nonconstant growth DCF performed by Mr. Gorman.

Next, SCEUC argues that that we erred in excluding gas distribution companies as comparables to SCPC. SCEUC maintains that this Commission “completely failed to acknowledge that more than forty percent of SCPC’s gas sales are to its sister company, SCE&G, a gas distribution company, “ and “failed to recognize that the primary risk for the transmission companies cited as comparables is the requirement of FERC Order 636 that the companies offer firm transportation service on an unbundled basis.” As to SCPC’s sales to SCE&G, Pipeline witness Hulse testified that, in evaluating SCPC’s risks, the market would not focus upon the resale customers like SCE&G but would look to SCPC’s industrial load, which contributes almost 90% of SCPC’s net income. Hulse also testified that, although the competition SCPC faces is a different type of competition than is created by FERC Order 636, the risk factors are nevertheless the same. Accordingly, the Commission’s conclusion that SCPC has corresponding risk and uncertainties to other gas transmission companies is supported by the record.

Further, we hold that our adoption of Staff witness Spearman's calculated DCF returns for gas transmission companies as appropriate for Pipeline's overall rate of return was not erroneous. We properly determined that Dr. Spearman's weighting of DCF returns for the two groups of gas companies was inappropriate because SCPC's risks are most comparable to those of the gas transmission companies. It was not required to accept Dr. Spearman's analysis on an all or nothing basis.

Also, SCEUC alleges as error our decision to set a range for SCPC's rate of return, rather than a specific rate. This allegation is without merit. The South Carolina Supreme Court has specifically rejected this same argument. See South Carolina Cable Television Association v. Public Service Commission, 313 S.C. 48, 437 S.E. 2d 38 (1993)(citing Southern Bell Telephone & Telegraph v. Public Service Commission, 270 S.C. 590, 244 S.E. 2d 278 (1978)). Moreover, the Commission's decision to adopt a broad range as a fair rate of return is clearly supported by the record. SCPC witness Wright testified that a rate of return range, as opposed to a single point estimate, will help account for the vagaries in the revenues and return associated with the industrial market. Wright noted that otherwise, depending on various factors, the Company and the Commission "would likely be involved in rate proceedings almost continuously as they chase the ever changing actual rate of return."

In addition, SCEUC further argues that monitoring rates "to ensure that they fall within a four-point range is inadequate and fails to meet the PSC's lawful duty." Contrary to SCEUC's argument, this monitoring process does comply with the Circuit Court's statement that "prices must be set by a method which will ensure that only a fair overall

return is earned.” Absent evidence that SCPC’s earnings are outside the fair rate of return established by the Commission, there is nothing left for the Commission to do. Certainly, there is no evidence in this proceeding that indicates Pipeline is earning above the range approved by the Commission. Also, the record amply supports the Commission’s decision to use the rate of return range to monitor SCPC’s future earnings. As Dr. Wright testified, SCPC’s earnings are subject to dramatic changes because of the competitive industrial market, such that it would be more appropriate to monitor earnings over an extended period of time and initiate a review only when earnings consistently fall outside the targeted range.

Finally, SCEUC alleges that Order No. 98-415 violates S.C. Code Ann. Section 1-23-350 (1976), apparently because the Commission’s findings of fact and conclusions of law are set forth under a single heading. Section 1-23-350 does not prescribe any particular format, however, nor does it require that findings of fact and conclusions of law be stated or enumerated under separate headings. See Seabrook Island Property Owners Association v. South Carolina Public Service Commission, 303 S.C. 493, 401 S.E. 2d 672 (1991) and Hamm v. American Telephone & Telegraph Company, 302 S.C. 210, 394 S.E. 2d 842 (1990). The statute does require the Commission to set forth findings of fact that are sufficiently detailed to enable a reviewing court to determine whether they are supported by the evidence and whether the law has been properly applied to them. See Able Communications, Inc. v. South Carolina Public Service Commission, 290 S.C. 409, 351 S.E. 2d 151 (1986). Our Order No. 98-415 meets this requirement, in that it contains a clear and concise statement of the appropriate factual

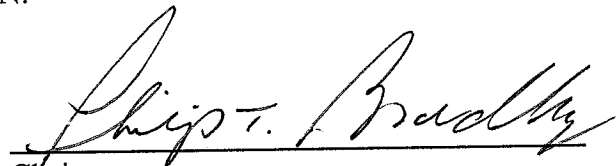


findings, which are supported by the evidence and which are consistent with the applicable law.

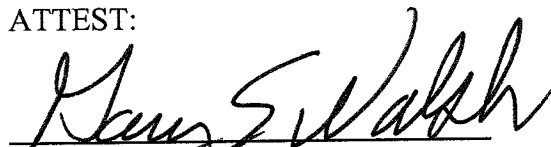
Based upon the foregoing reasoning, we hold that SCEUC has failed to show any sufficient reason for the Commission to grant a rehearing on, or reconsideration of, any of the matters raised in SCEUC's petition. Accordingly, we hereby deny the petition in all particulars.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

  
Chairman

ATTEST:

  
Acting Executive Director

(SEAL)